

OCT - 7 1991

UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF NORTH CAROLINAJ. BARON GROSHON
BY:
Deputy Clerk

In Re:

A.J. NIELSON and
DORIS NIELSON,

Debtors.

Case No. 87-10439
Chapter 12

JUDGEMENT ENTERED ON OCT - 7 1991

ORDER COMPELLING TRUSTEE'S PAYMENT OF TAXES
AND FINAL DISTRIBUTION

This matter is before the court on First Union National Bank's Motion to Compel Trustee to Close Estate and to Make Final Distribution. The Chapter 12 Trustee has requested guidance from the court regarding the responsibility for payment of state income taxes resulting from the post-confirmation sale of the debtors' farm assets. The court has concluded that the Trustee is responsible for the payment and filing of taxes resulting from the liquidation of the debtors' assets. Further, such taxes are administrative expenses under § 503(b) of the Bankruptcy Code and are entitled to priority status.

BACKGROUND

Prior to bankruptcy the debtors operated an apple farm in Henderson County, North Carolina. Mr. Nielson also owned a fifty percent interest in a family corporation, Nielson Development Corporation.¹

¹ Nielson's son owned the other fifty percent interest, but the court has previously found that Nielson operated the corporation as his own alter ego.

This Chapter 12 case was filed on September 9, 1987. Pursuant to 11 U.S.C. § 1202(a), a Chapter 12 Trustee was appointed.

During the course of this bankruptcy case, the debtors proposed five plans of reorganization. Several proposed plans to rehabilitate the debtors were not confirmable for lack of feasibility. The Plan finally confirmed by the court provided for a liquidation of all of the debtors' non-exempt personal property and the sale of all the debtors' real property with the possible exception of one 18-acre tract, which the debtors would attempt to keep if other receipts were sufficient to consummate the Plan. (That attempt ultimately failed). The Plan specified that it was the responsibility of the Trustee to sell all of the debtors' assets -- and provided for sale of the debtors' assets by auction.

During the course of the case leading up to the confirmed "liquidation" Plan, there were numerous allegations of wrongdoing by the debtors. These allegations included conversion and misappropriation of assets, attempts to tamper with the auction of the debtors' property by soliciting friendly "low-ball" bids and threats of physical harm to Farmers Home Administration (hereafter "FmHA", a secured creditor) employees. The accumulation of these alleged actions resulted in an Order which required that all the equipment subject to FmHA's security interest be returned to the Trustee; that the debtors make no further sales of property; that the debtors cooperate with the Trustee and his

agents "under penalty of contempt;" and that the U.S. Marshal provide appropriate protection in preparation for an execution of the auction of the debtors' property (as a result of the alleged threats).

Just prior to consummation of the Plan, and over a year and a half after filing, the debtors filed a motion to dismiss their Chapter 12 case. The court denied the debtors' motion, concluding that it was an abuse of the bankruptcy process in an attempt further to delay the liquidation of the debtors' property, and ordered the Trustee to continue the liquidation according to the confirmed Plan.

Pursuant to the Chapter 12 Plan, the Trustee sold at auction all of the debtors' non-exempt property.

DISCUSSION

This issue presented here upon the Chapter 12 Trustee's sale of the debtors' property is who is liable for the payment of state² income taxes that arise on account of the sale; and, if the Trustee incurs the liability for taxes, then in what manner or priority should they be paid.

A. Responsibility of Payment of Taxes

Throughout the Bankruptcy Code there are specific tax requirements applicable to each Chapter. Section 346 of the Code provides some general requirements that apply to all filings. Specifically, § 346(b)(1) establishes the separate entity rules

² The parties have agreed that federal taxes are not the subject of this motion.

in Chapter 7, 11 and 12 for taxes attributable to the estate and not to the debtor.³ Section 1231 of the Code addresses the tax responsibilities for a Chapter 12 estate:

(a) For the purpose of any State or local law imposing a tax on or measured by income, the taxable period of a debtor that is an individual shall terminate on the date of the order for relief under this chapter, unless the case was converted under section 706 of this title.

(b) The trustee shall make a State or local tax return of income for the estate of an individual debtor in a case under this chapter for each taxable period after the order for relief under this chapter during which the case is pending.

11 U.S.C. § 1231 (a) and (b). The critical issues for a determination of the tax responsibility in this case are: (1) the period during which a Chapter 12 case is deemed "pending," and; (2) the effect, if any, the liquidating nature of the Chapter 12 case has on this determination. Because there is no case law addressing these issues in a Chapter 12 proceeding (much less a liquidating Chapter 12), analogies can be drawn to a Chapter 7 liquidation and a liquidating Chapter 11 for guidance.

In a Chapter 7 case the tax attributes are governed by § 728 of the Code. Section 728(b) has similar language to that found in § 1231: "the trustee shall make tax returns of income for the estate of an individual debtor ... for the entire period after the order for relief under this chapter during which the case is pending." 11 U.S.C. § 728(b) (emphasis added). The Committee Notes following that section indicate that a case is "pending"

³ Chapter 13 cases are expressly excluded from the separate entity rules in § 346(d); thus, all taxes are the responsibility of the debtor.

until the case is closed. Thus, at first glance, a Chapter 12 case could be deemed pending until the case is closed.

However, a Chapter 12 case may be more akin to a Chapter 11 due to the procedural posture of the case focusing on pre- and post-confirmation events. The tax provisions applicable to Chapter 11 cases are in § 1146 of the Code. The language addressing the payment of state and local taxes by the estate is identical to the language in § 1231:

[t]he trustee shall make a State or local tax return of income of the estate of an individual debtor in a case under this chapter for each taxable period after the order for relief under this chapter during which the case is pending.

11 U.S.C. 1146(b) (emphasis added). The event of confirmation provides a time period that is not present in a Chapter 7 case; a case may be "pending" in Chapter 11 or 12 only until confirmation when the property of the estate reverts in the debtor, thus, cutting off the Trustee's administration of the estate and presumably all rights and responsibilities to the estate property. 11 U.S.C. §§ 1141(b), 1227(b) ("[e]xcept as otherwise provided in the plan or the order confirming the plan, the confirmation of a plan vests all of the property of the estate in the debtor").

An Eleventh Circuit decision involving a Chapter 11 case has concluded that the Trustee's administration of the estate terminates for federal tax purposes upon confirmation of the plan. Smith v. United States (In re Holywell Corp.), 911 F.2d 1539 (11th Cir. 1990), cert. granted, ___ U.S. ___, (1991). Holywell was a liquidating Chapter 11 case. The plan required the Trustee

to consolidate all of the debtors' property and liquidate that property according to the plan. The plan did not contain a provision for payment of federal taxes or a requirement for filing tax returns.⁴ The Trustee brought a declaratory judgment action to determine the obligation to file income tax returns and pay taxes resulting from sales of the debtors' property that occurred both before and after confirmation. Id. at 1539-42.

The plan provided that all "costs, expenses and obligations incurred by the Trustee in administering the Trust" were to be charged against the Trust and entitled to priority over the holders of unsecured claims. Id. at 1545. The court concluded that the "administration of the estate ceases upon confirmation of a plan or reorganization.... Thus, taxes which accrue post-confirmation are not incurred in administering the Trust, and are not recoverable under ... the Plan." Id. (citations omitted). Implicitly, taxes resulting from pre-confirmation sales of property were payable by the Trustee under the plan. The court reached this conclusion based on the premise that property of the estate reverts in the debtor upon confirmation - terminating the Trustee's administration of the estate. Id. at 1544."

The present case is similar to Holywell due to the liquidating nature of the proceedings. Nevertheless, it is arguable in both cases that the property of the estate never reverted in the

⁴ The special tax considerations in § 1146 of the Bankruptcy Code address only the payment of state and local taxes while the case is pending and is therefore, inapplicable to payment of federal taxes.

debtors. Here, in particular, the Trustee remained in control of the property, sold the property against the debtors' wishes, and will dispose of the proceeds without any further action by the debtors. The failure to devise a workable Chapter 12 plan of reorganization and the seemingly improper actions taken by the debtors virtually transformed, albeit without a formal conversion, the Chapter 12 petition into a Chapter 7 liquidation. The Plan required the Trustee to liquidate all of the debtors' property to satisfy their creditors. The debtors had no control over the property, the auctions or the proceeds. Nothing in the administration of the estate would have been different had the case been converted to a Chapter 7 case. In a Chapter 7 case the Trustee has the responsibility to pay the taxes resulting from the liquidation of a debtor's estate. In the present case, because the Trustee sold the property that created the tax liability, the Trustee should also be responsible for payment of that liability. Further, even under a Chapter 11 analogy, the debtors' property reverts in the debtor upon confirmation "except as otherwise provided in the plan." 11 U.S.C. §§ 1141(b) and 1227(b). Since the Plan provided for sale of the debtors' property by the Trustee, it follows that the Trustee should bear the burden of the tax consequences.

For all of the above reasons, the court has concluded that the state income tax obligations arising from the Chapter 12 Trustee's sale of the debtors' property in the peculiar circumstances of this case are the obligation of the Trustee.

B. Status of Tax Claim

Section 503(b)(1)(B) of the Code provides that "the actual, necessary costs and expenses of preserving the estate, including ... any tax incurred by the estate, except a tax of a kind specified in section 507(a)(7)⁵ of this title" are administrative expenses. 11 U.S.C. § 503(b)(1)(B). Because the court has concluded that the Trustee's administration of this estate extended until the Trustee completed the liquidation of the debtors' property, the state income taxes resulting from the liquidation are entitled to administrative expense status.

In Holywell, the court rejected the debtors' assertion that the post-confirmation federal taxes were administrative expenses. 911 F.2d 1539, 1544. That conclusion was based on the premise that the Trustee's administration of the estate terminated on confirmation. In the present case, the court has concluded that the administration did not cease on confirmation of the Plan and the state income taxes are, therefore, entitled to administrative priority status.

CONCLUSION

This Chapter 12 case resulted in the liquidation of all of the debtors' property. The Plan required the Trustee to perform all aspects of the liquidation, thus, the Trustee's responsibilities necessarily continued post-confirmation. The taxes incurred upon the liquidation of the debtors' property were incurred by the estate, as a result of the Trustee's actions. As such,

⁵ Section 507(a)(7) refers only to pre-petition taxes.

pursuant to § 1226(b) of the Code, the Trustee's responsibility to file and pay taxes of the estate while the case is pending includes those state income taxes resulting from post-confirmation sales of the debtors' property. The taxes incurred during the Trustee's administration of the estate are deemed an administrative expense.

It is therefore ORDERED that:

1. The Trustee file and pay the state income taxes resulting from the post-confirmation sales of the debtors' property;
2. Such taxes are entitled to administrative priority status; and
3. The Trustee should proceed to complete distribution of funds in the estate in accordance with this Order.

This the 31 day of October, 1991.



George R. Hodges
United States Bankruptcy Judge